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Barriers to Small Business Formation

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## Barriers To Small Business Formation

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### Abstract

This research analyzed the demographic and opinion profiles of individuals who were identified by the Massachusetts Small Business Development Center as new venture candidates. Demographic differences between those that actually formed a business and those that did not were found to be related to sex, position, and number of dependents. Opinions on the most important factors (barriers) were identified as product, availability of financing and rewards and satisfaction from forming the business. Factors (barriers) which were not important were identified as the state and federal tax climate and foregoing the security of present employment. Of those which did not form a business, there were no demographic differences between those which still wished to form a business and those which were discouraged and gave up their aim of forming a business.





## Barriers To Small Business Formation

Every year a large number of new businesses are formed in the U.S. For the most part, the majority of these enterprises are small business formed by a single entrepreneur or a group of entrepreneurs. Considerable information and statistics are collected and made available on the number of new jobs, the amount of gross revenue, and the increase in the tax base of both the state and the national economy as a result of these new business formations. Various state and federal programs designed to abet and encourage business formation are also well documented. A number of studies have been conducted which track the new businesses from their inception through various stages of development and growth and ultimately success or failure as an ongoing enterprise. Still another avenue of research has profiled the entrepreneur and identified the qualities necessary for success in forming a new business.

However relatively little information is available on the businesses that were not formed. That is, those businesses that remained in the conceptual stage in the mind of the entrepreneur and were never nurtured into reality. Little is known of the individual that had an idea and a desire to form a new business, but for some reason did not. What are the barriers that prevented the would-be entrepreneur from forming the new business enterprise? Obviously there must have been a number of reasons that prevented the individual from pursuing their desire to form a new business. Such forces as the general market environment, the financial and tax climate, personal objectives and responsibilities, and family security, well being and commitments are

all possible reasons which may have deterred the would-be entrepreneur. Knowledge about the reasons why some people did not go into business can be potentially useful for policy makers, whose objective is to make the environment conducive to business formation.

It is appropriate therefore that a study be made of individuals that had a desire to form a new business. This group of would-be entrepreneurs self selects into two final categories; those that went ahead and formed new businesses and those that for some reason did not. In comparing the characteristics and beliefs of these two groups, we will be able to gain some insight into the entrepreneurial process. Furthermore, it is important to identify those actual or perceived barriers that prevented the formation of the new business. This will allow for recommendations to policy makers which will remove or lower the entry barriers. The economic loss from businesses that were not formed is very difficult, if not impossible, to calculate or to recoup. However the removal or lowering of barriers can insure that such future economic opportunity losses would not occur and could lead to economic gains from the new business formations.

#### Objectives of Research

This research will consider five specific questions:

- 1) What factors are important to an individual who is considering forming a business?
- 2) What barriers prevented prospective entrepreneurs from forming new businesses?
- 3) Are there differences in the perception of the barriers between those who actually started new businesses and those who were discouraged and did not start a new business?

- 4) Are there demographic differences between those individuals who started new businesses and those who were discouraged and did not start a new business?
- 5) Do discouraged entrepreneurs continue to maintain the desire to form a new business?

#### Data and Research Methodology

The data base for the study consists of those individuals who inquired of the Massachusetts Small Business Development Center (MSBD) about the formation of a new business. The MSBD consists of nine centers in Massachusetts that were formed and supported with federal and state government funding to encourage the growth of small business. The individuals in the data base have received at least five hours of consultation from MSBD consultants on procedures and problems of new business formation. This group consists of 630 individuals who received MSBD services during the 1982-1983 period. These individuals are considered to be serious new business candidates by the MSBD staff.

A survey questionnaire was sent to the 630 serious new business candidates. This questionnaire is contained in Appendix A. The initial response rate was 26 percent or 161 out of 630. This number of useable responses was considered sufficient and representative in that no further follow-up was performed. The responses were divided into two groups: those individuals which actually formed a business and were operating when they received the questionnaire, and those which had not formed a business when they received the questionnaire. The number of individuals who responded and had formed a business was 112.

The number of individuals who responded and had not formed a business was 49.

The questionnaire gathered three types of information. The first type of information was the individual's opinion on the importance of three factors related to business functions: the product, general market conditions and environment, and personal considerations. The question on the individual's opinion about the importance of the market potential (4d) was aimed at measuring the belief of the individual in the product. The questions on financing (4a), general state of the economy (4c), tax climate (4f) were aimed at measuring the importance of factors which were outside of the control of the individual. The personal questions on personal financial risk (4b), personal security of present employment (4e), rewards and satisfaction (4g), family responsibilities (4h), and being the boss (4i) were aimed at measuring the importance of personal decisions within the control of the individual.

The second type of information was basic demographic data such as age, education, sex, salary, size of family and experience. This information was used to get a profile of the differences of those individuals who actually formed new businesses from those individuals who did not. It was also used in trying to explain the type of individual who would be more likely to place personal factors ahead of environmental factors in deciding whether or not to go into business.

The final information was the individual's response to the question, Are you still considering going into business? This information was used to see if there were any differences between the



profiles of those who did not go into business but were still interested and those who did not go into business and were no longer interested in forming a business.

Demographic profiles were formed for both groups, those that went into business and those that did not. Chi-square independence tests were used to determine if the group profiles were similar to each other.<sup>1</sup>

1. The Chi-square independence test

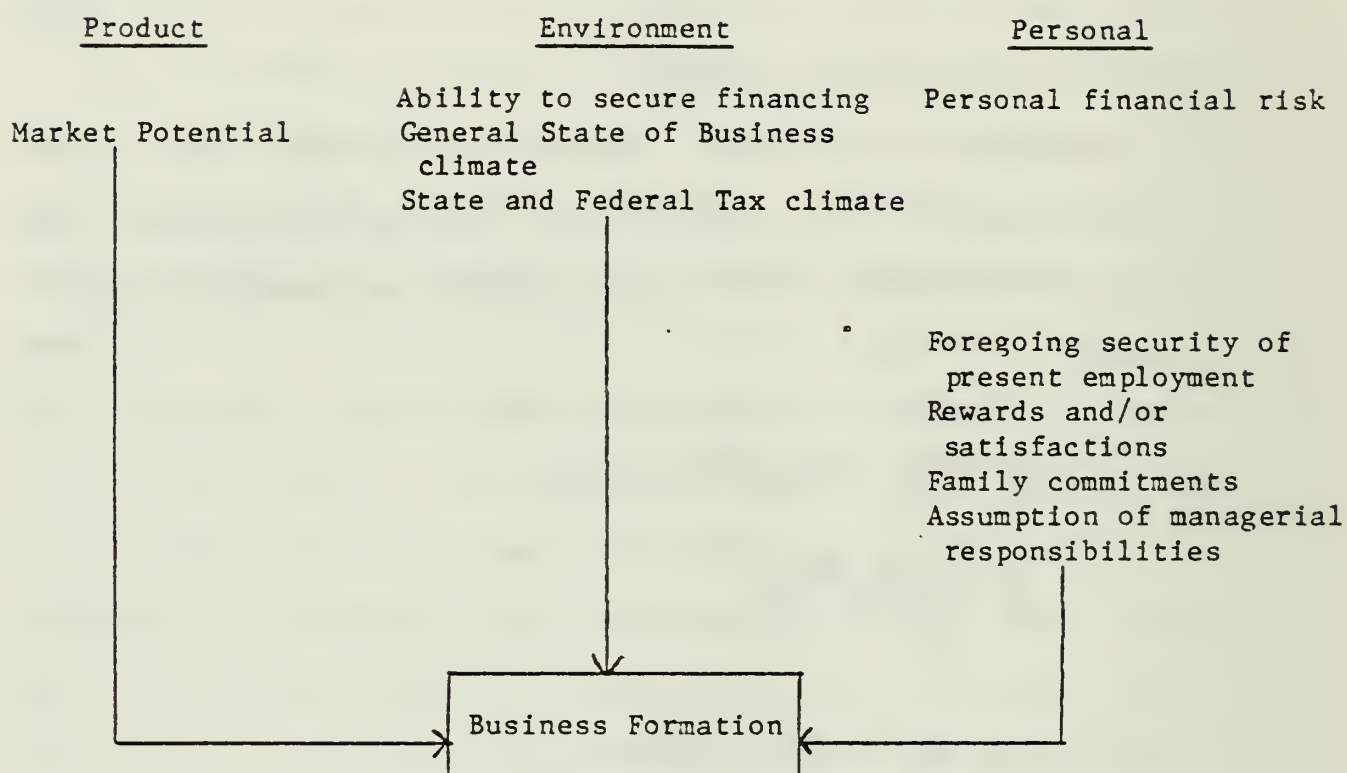
$$\chi^2 = \sum_{ij} \frac{(O_{ij} - E_{ij})^2}{E_{ij}}$$

where  $O_{ij}$  is the observed frequency

$E_{ij}$  is the expected frequency

The opinion profiles were analyzed in two ways: (1) conditional probabilities were calculated and (2) F ratios were calculated. These F ratios were then used as a measure of the affect of each opinion variable on whether someone formed a business or not. Using the results of these analyses, the three factors of product, environment, and personal that may serve as a barrier to business formation were investigated. The diagram in Figure 1 shows schematically the barriers to business formation as defined in this study.

Figure 1. Barriers To Small Business Formation



Finally,  $X^2$  independence tests were performed on the group that did not go into business to see if there were distinguishable differences between those that continued to have an interest in forming a new business and those that did not.

### Results

The demographic profiles of the two groups, those that formed a business and those that did not are presented in Table 1. From the  $X^2$  test of independence we see that the two groups are similar in five factors; age, education, salary, number of years experience in industry, and experience in business, and are not the same in three factors; sex, position, and dependents. Looking at the factors that were different between groups, we see that the females, owners or

Table 1. Demographic Profile

Factor	Percentage of Those Responding in Each Category					$\chi^2$	Probability of Equality
AGE	Formed Business	30	31-50	51-65	over 65	4.5	2.22%
	Yes	10%	80%	9%	1%		
	No	12%	67%	19%	2%		
SEX	Male	Female				4.6	3.4%**
	Yes	63%	37%				
	No	80%	20%				
EDUCATION	High School	Graduated College		Graduate School		2.8	26.2%
	Yes	23%	46%	31%			
	No	27%	32%	41%			
SALARY	Less \$20,000	\$20,000-35,000		\$36,000-50,000		.94	88.3%
	Yes	39%	40%	13%	8%		
	No	43%	35%	16%	6%		
POSITION	Management or Owner	Employee		Retired	Unemployed	25.0	.00%***
	Yes	88%	10%	2%	0%		
	No	55%	39%	2%	4%		
EXPERIENCE IN INDUSTRY	Less 5	6-10	11-20	Over 20		1.7	72.5%
	Yes	43%	25%	20%	12%		
	No	33%	33%	22%	12%		
DEPENDENTS	1	2	3	4	Over 4	8.0	9.4%*
	Yes	28%	19%	19%	23%		
	No	45%	12%	16%	25%		
EXPERIENCE IN BUSINESS	Yes	No				.18	89.3%
	Yes	48%	52%				
	No	45%	55%				

\*Significant at the 10% level

\*\*Significant at the 5% level

\*\*\*Significant at the 1% level

managers, with a greater number of dependents were more likely to go into business than single males who were employees. These results pose some interesting questions as to why sex, position, and number of dependents were related to actual business formation. Further research is required to ascertain the general applicability of these findings and the behavioral factors which are suggested.

The conditional probabilities of the factors given the respondent went into business or did not go into business are presented in Table 2.

Three factors were the most significant in the opinion of those who responded to the survey: (1) the market potential for the product, (2) the ability to secure financing, and (3) the rewards and satisfaction of forming a business. The importance of the product was very important to 64 percent and important to 31 percent. The ability to secure financing was very important to 59 percent and important to 24 percent. The rewards and satisfaction was very important to 62 percent and important to 34 percent. The importance of these three factors can give us some insight into the types of programs or efforts that must be undertaken in order to encourage the potential business founder. Help in determining a realistic market and market potential for the proposed new venture appears to be an area that needs a lot of support. Not too surprising is the importance of securing financing for the proposed new venture, in the area not only the securing of funds but also the generation of information about the sources of potential funding would be very helpful. The importance of personal rewards and satisfaction is an area that is very difficult to provide



Table 2. Conditional Probabilities of Factors

<u>Business Formed</u>	<u>Factors</u>	<u>VI</u>	<u>I</u>	<u>NI</u>	<u>NA</u>
	<u>Product</u>				
Yes	Market Potential	47%	20%	1%	1%
No		17%	11%	2%	1%
	Relative Frequency	64%	31%	3%	2%
	<u>Environment</u>				
Yes	Ability to secure financing	42%	16%	9%	3%
No		17%	8%	2%	3%
	Relative frequency	89%	24%	11%	6%
Yes	General State of Business Climate	19%	37%	12%	3%
No		6%	16%	6%	1%
	Relative Frequency	25%	53%	18%	4%
Yes	State and Federal Tax Climate	6%	30%	30%	4%
No		4%	9%	12%	5%
	Relative Frequency	10%	39%	42%	9%
	<u>Personal</u>				
Yes	Personal Financial Risk	32%	30%	7%	0%
No		7%	14%	8%	2%
	Relative Frequency	39%	44%	15%	2%
Yes	Security of Present Employment	12%	22%	27%	8%
No		4%	7%	14%	6%
	Relative Frequency	16%	29%	41%	14%
Yes	Reward and/or Satisfaction	42%	26%	1%	0%
No		20%	8%	2%	1%
	Relative Frequency	62%	34%	3%	1%
Yes	Family Commitments	26%	28%	11%	4%
No		11%	11%	6%	3%
	Relative Frequency	37%	39%	17%	7%
Yes	Assumption of Marginal Responsibilities	27%	29%	11%	2%
No		11%	12%	5%	3%
	Relative Frequency	38%	41%	16%	5%

outside support in an organized fashion and may be one of the barriers that is most difficult for the individual to overcome.

On the other end of the scale two factors appear to be not very important to the prospective business founder; (1) the Federal and State Business Climate and (2) the security of present employment. In terms of the tax climate, one explanation for the relative importance of this factor may be the actions that have already been taken by governmental agencies in providing tax breaks and tax incentives to business formation. Another possibility is that the prospective new venture has not fully thought through the profit and tax implications of their proposed business. Since this is a relatively surprising finding, more effort should be expended to resolve the question of whether the tax climate in a given state poses a true barrier to business formation. At least on the surface, it is an area that has received a lot of time and effort and may not really be as important of a barrier as some think. The second factor which was rated as not important was the security provided by present employment. Again there may be two explanations of this finding. Either the people in the sample have not been employed long enough to qualify for all of the security oriented programs offered by firms or they do not perceive employment security as being an important sacrifice when they consider forming a new venture. In either case further investigation is required before this issue can be fully understood.

The importance of the factors is further investigated by looking at the F value concerning the affect of the factors on whether a new business was actually formed or not. As indicated in Table 3, except

Table 3. Comparison Between Groups of Factor Importance

<u>Factor</u>	<u>F Value</u>	<u>Conclusion</u>
Product - Market Potential	.79	No difference between groups in the importance of product
Environment - Ability to secure financing	1.43	No difference between groups in the importance of financing
- General state of business climate	2.53	No difference between groups in the importance of business climate
- State and federal tax climate	12.61*	Difference between groups in the importance of tax climate
Personal - Personal financial risk	2.55	No difference between groups in the importance of proved risk
- Security of present employment	6.60**	Difference between groups in the importance of security of present employment
- Reward and/or satisfaction	1.06	No difference between groups in the importance of rewards and/or satisfaction
- Family commitments	2.02	No difference between groups in the importance of family commitments
- Assumption of managerial responsibilities	4.24	No difference between groups in the importance of managerial responsibilities

\*Significant at the 5% level

\*\*Significant at the 1% level

for the importance of the state and federal tax climate and security of present employment, both those who actually formed a business and those who did not form a business agreed on the importance of the product, environment and personal factors in their decision to form a business.

The final question that was investigated dealt with the group of entrepreneurs who decided not to form a business. Of interest is the issue of whether there are differences between those who still desire to form a business and those who have no further desire to form a business. Two investigations were performed: (1) the differences in demographic profiles and (2) the differences in opinion on the importance of product, environment, and personal factors. The results of the first analyses are presented in Table 4.

There were no statistical differences in the demographic characteristics of those individuals who were still interested in forming a business and those individuals who had given up their desire to form a business. The results of the analysis of the second issue, differences in opinion are presented in Table 5.

The individuals who have lost their desire to go into business have a different opinion from those individuals who continue to have a desire to go into business on the importance of the factors of the general state of the business climate, the security of present employment and family commitments.

#### Summary and Implications

This study sought to identify demographic differences between individuals who form business and those who do not, and opinions about



Table 4. Differences Between Those Who Still Desire To Form A Business and Those Who Do Not

FACTOR	Still Considering Forming Business	Percentage of Those Responding in Each Category				X <sup>2</sup>	Probability of Equality	
		Less 30	31-50	51-65	Over 65			
Age	Yes	11%	72%	17%	0%	3.63	32.1%	
	No	15%	54%	23%	8%			
Sex		Male	Female			1.46	23.0%	
	Yes	86%	14%					
	No	69%	31%					
Education		High School	College	Graduate	School	.30	86.4%	
	Yes	28%	31%	41%				
	No	24%	38%	38%				
Salary		Less \$20,000	\$20,000- 35,000	\$36,000- 50,000	Over 50,000	2.81	43.3%	
	Yes	39%	39%	19%	3%			
	No	54%	23%	8%	15%			
Position		Management or Owner	Employee	Retired	Unemployed	.95	89.5%	
	Yes	56%	38%	3%	3%			
	No	54%	23%	8%	15%			
Experience in Industry		Less 5	6-10	11-20	Over 20	2.96	41.5%	
	Yes	28%	33%	28%	11%			
	No	46%	31%	8%	15%			
Dependents		1	2	3	4	4.35	31.2%	
	Yes	39%	17%	19%	22%			3%
	No	62%	0%	8%	30%	0%		
Experience in Business		Yes	No			1.96	15.0%	
	Yes	61%	39%					
	No	38%	62%					

\*Significant at the 10% level

\*\*Significant at the 5% level

\*\*\*Significant at the 1% level

Table 5. Differences in Opinion With Respect to Factor Importance

<u>Factor</u>	<u>F Value</u>	<u>Conclusion</u>
Product - Market Potential	.83	No difference between groups in the importance of product
Environment - Ability to secure financing	1.26	No difference between groups in the importance of financing
- General state of business climate	5.85**	Difference between groups in the importance of business climate
- State and Federal tax climate	2.31	No difference between groups in the importance of tax climate
Personal - Personal financial risk	1.87	No difference between groups in the importance of personal financial risk
- Security of present employment	7.25**	Difference between groups in the importance of security of present employment
- Reward and/or satisfaction	1.28	No difference between groups in the importance of rewards and/or satisfaction
- Family commitments	6.83**	Difference between groups in the importance of family commitments
- Assumption of managerial responsibility	3.18	No difference between groups in the importance of managerial responsibility

\*Significant at the 5% level

\*\*Significant at the 10% level

the relative importance of factors one considers when they are making a decision to form a new venture. A survey of serious new venture candidates was conducted and a data base with demographic and opinion data was constructed based on an initial response rate of 26 percent.

In terms of business formation, the demographic characteristics of those that formed a new business and those that did not differed with respect to sex, present position and number of dependents. A female who is presently in a managerial position and has dependents is more likely to form new venture than a single male who is an employer.

The factors that are important to an individual who is considering forming a new business are the market potential for the proposed product, the availability of financing and the rewards and satisfaction of forming the business. Two factors which one would normally consider to be important, the tax climate and present job recently were found not to be important considerations for those surveyed.

For the most part, those who formed a business and those who did not agreed on the relative importance of product, business environment and personal factors. The only differences were for the opinions on the state and federal tax climate and the security of present employment.

The final issue of the paper dealt with those who decided not to form a business. Of interest was the response to the question: Are you still considering going into business? In terms of demographics there were no differences between those who still wished to form a business and those who had given up their desire to form a business. However, these were differences of opinion as to the importance of the

general state of the business climate, the security of present employment and family considerations between those who still had an interest in forming a business and those who did not have an interest.

One of the initial premises of this study was the importance of understanding the characteristics and opinions of the new venture individual. The data gathering techniques used were based upon the \*serious new venture and his or her perceptions. Since the formulation and implementation of programs which serve to encourage new business formation depend on the characteristics and opinions of those they intend to serve, it is important to identify the type of individual who is most likely to start a new venture.



1. DID THE ASSISTANCE YOU RECEIVED FROM THE SBDC AID YOU IN YOUR DECISION TO GO INTO BUSINESS? \_\_\_ Yes \_\_\_ No
2. DID YOU GO INTO BUSINESS? \_\_\_ Yes \_\_\_ No  
 If you response is yes, please complete a-e below.  
 If your response is no, proceed to #3.
  - a. When did you go into business? 19 \_\_\_
  - b. Are you still in business? \_\_\_ Yes \_\_\_ No
  - c. Number of employees presently employed? \_\_\_ part-time \_\_\_ full-time
  - d. Gross sales (from last financial statement). \$ \_\_\_\_\_
  - e. Net profit/loss (including total owners compensation). \$ \_\_\_\_\_
3. ARE YOU STILL CONSIDERING GOING INTO BUSINESS? \_\_\_ Yes \_\_\_ No
4. IN YOUR DECISION OF WHETHER OR NOT TO GO INTO BUSINESS, PLEASE INDICATE THE IMPORTANCE OF THE FOLLOWING. (VI = Very Important, I = Important, NI = Not Important, N/A = Not Applicable)

VI / I / NI / NA

- |   |     |   |     |   |     |   |     |
|---|-----|---|-----|---|-----|---|-----|
| a. Ability to secure necessary financing to form the business | ___ | / | ___ | / | ___ | / | ___ |
| b. The personal financial risk required to form the business  | ___ | / | ___ | / | ___ | / | ___ |
| c. The general state of the business climate                  | ___ | / | ___ | / | ___ | / | ___ |
| d. The market potential for the proposed business             | ___ | / | ___ | / | ___ | / | ___ |
| e. Foregoing security of present employment                   | ___ | / | ___ | / | ___ | / | ___ |
| f. State and federal tax climate                              | ___ | / | ___ | / | ___ | / | ___ |
| g. Rewards and/or satisfactions from forming the business     | ___ | / | ___ | / | ___ | / | ___ |
| h. Family commitment and responsibilities                     | ___ | / | ___ | / | ___ | / | ___ |
| i. Assumption of managerial responsibilities                  | ___ | / | ___ | / | ___ | / | ___ |

5. GENERAL

- Age: \_\_\_ under 30 \_\_\_ 31-50 \_\_\_ 51 to 65 \_\_\_ over 65
- Sex: \_\_\_ male \_\_\_ female
- Education: Graduated from: \_\_\_ High School \_\_\_ College \_\_\_ Graduate School
- Salary: \_\_\_ under \$20,000 \_\_\_ \$20-\$35,000 \_\_\_ \$36-\$50,000 \_\_\_ over \$50,000
- Present Position: \_\_\_ Management/ Self Employed \_\_\_ Employee \_\_\_ Other (Specify) \_\_\_\_\_
- Experience in Industry: \_\_\_ less than 5 yrs \_\_\_ 6-10 yrs \_\_\_ 11-20 yrs \_\_\_ over 20 yrs
- Family Dependents (including self): \_\_\_ 1 \_\_\_ 2 \_\_\_ 3 \_\_\_ 4 \_\_\_ over 4
- Was proposed business similar to job held?: \_\_\_ Yes \_\_\_ No
- Did you have any experience in proposed business?: \_\_\_ Yes \_\_\_ No







